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Remarks on “Managing Longevity Risk” at the Financial Innovation and Retirement Security: From Ideas to Implementation Conference*  
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Product Proposal: Birthday CDs  
- Makes only one fixed payment when you reach a certain birthday  
- Principal and interest forfeit if you die before payment date  
- Higher return (conditional on being alive) due to mortality premium  
- Payment date must be at least 10 years in the future

Example:  
At age 65, you can buy $10,000 of an 80th Birthday CD, which pays out $31,722 (8% annualized return) on your 80th birthday if you’re alive.

Virtues:  
- Simple to understand  
- Analogous to a familiar and popular pre-retirement product (CDs)  
- Makes customers feel in control of their finances  
- By buying Birthday CDs for multiple ages far into the future, can realize much of the insurance gains of a life annuity  
- Long lag until payment mitigates adverse selection risk  
- Long lag until payment makes final payment look impressively big due to exponential growth bias (the common failure to recognize how quickly compounding works)

Concern:  
- Burden of constructing good longevity insurance placed on individual. May be able to mitigate burden through clever menu design.

Background  
People dislike annuities  
Brown, Casey, and Mitchell (2007):  
- 60% of people prefer actuarially fair lump sum over Social Security annuity  
- 40% of people prefer lump sum 25% below actuarial fair value over Social Security annuity

People don’t understand the insurance feature of annuities  
Brown and Warshawsky (2004), citing ACLI research: “some consumer focus group participants equated lifetime annuity payments with gambling on their lives.”

* The ideas here have been jointly formulated with Stefan Lewellen, Ph.D. Student in Finance, Yale University.
Popular financial education isn’t helping
Among all the financial advice books at the Yale Bookstore:

Financial advice books with little or no mention of annuities

Financial advice books with negative coverage of annuities
1. The Motley Fool Personal Finance Workbook; 2. The Road to Wealth; 3. The Lies About Money

Financial advice books with balanced coverage of annuities

Books tend to focus on investment properties of annuities, rather than insurance properties.

Educating people is hard
Especially among the elderly, who are in cognitive decline (Agarwal, Driscoll, Gabaix, Laibson, 2008)

Some things people dislike about annuities
Lack of liquidity
Loss of control
Irreversibility

But there is another popular illiquid asset with some similar properties
Time deposits under $100,000 in 2008: $1,228 billion
Upper bound on immediate annuity market in 2005: $12 billion

Birthday CDs can build off of familiarity and popularity of CDs
By buying multiple Birthday CDs, can achieve much of the insurance gains from life annuities. Argument is similar to that for delayed payout annuities (Scott, Watson, and Hu, 2006).

But also possible that people will not buy wise combinations of Birthday CDs. Could mitigate through prepackaged menu options. For example, buy the “80s combo” that covers ages 80-89. Could promise a higher return on package purchases.

Research steps
1. Survey almost-retired and just-retired households. Assess appeal of various flavors of Birthday CDs relative to self-annuitization. Are Birthday CDs appealing?

2. If an appealing Birthday CD flavor is found, conduct another study where almost-retired and just-retired households are asked to allocate hypothetical portfolios among choices that include the appealing Birthday CD flavors. Do households make sensible purchase choices? Are their choices positively influenced by package offerings?

3. Launch Birthday CD product. Measure the packages of Birthday CDs bought, household characteristics of buyers.

References

